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Review of Scottish Business Surveys

Overall

Three themes have been evident in almost all recent surveys. Firstly, the Scottish economy was 'clearly in a better position at the start of 2010 than it was twelve months ago' (Scottish Chambers' Business survey Q4 2009), 'This final survey of 2009 (is) the most heartening of the year' (Scottish Engineering Q4 2009). The Scottish Retail sales monitor reported 'solid December shop sales'. Secondly, business sales and optimism trends in the fourth quarter were not as strong as the third quarter. The PMI (December data) noted the 'Scottish economy recorded weaker rises in activity and new business in December' compared to November. The Scottish Chambers' Business survey noted 'fewer signs of a sustained recovery in manufacturing', and the CBI Scottish Industrial trends noted 'growth in total new orders was slower than in the previous quarter', however in contrast, Scottish engineering reported better trends for the fourth quarter, although these were less evident for machine shops and metal manufacturing. In retail December like-for-like sales growth was slightly weaker than in August – October, although disentangling the effects of the approaching end of the reduction in VAT and the exceptionally cold weather from overall trends in sales is problematic. Thirdly, 'the Scottish economy is set to emerge from recession and return to weak growth during the first quarter of 2010' (Lloyds TSB monitor).

Data from the Scottish Chambers' Business Survey shows that the net rising trends in business confidence in manufacturing in the fourth quarter were less strong than in the three months to September. In construction net declining trends have remained largely unchanged for the past three quarters. In retail confidence, especially in the non multiple retail sector, remains negative, whilst in tourism confidence remains weak, but the fourth quarter trends were better than in Q4 2008 and 2007. Lloyds TSB noted that whilst the Scottish economy 'has not yet returned to growth (it) is very close to the point of turnaround between decline and growth'.

Pay pressures remained subdued for a further quarter. The percentages of respondents reporting pay increases in the fourth quarter to the Scottish Chambers' Business Survey ranged from 5% of construction to 19% of manufacturing, and average pay increases ranged from 1.5% in wholesale to 2.8% in manufacturing.

Oil and Gas

Data from the new Oil & Gas UK index (latest data 2009 Q3) suggested that overall business confidence had improved slightly in 2009, reflecting the rising price of oil and the

easing access to finance. However, continued low wholesale gas prices were contributing to lower business confidence in the upstream sector and confidence remained weak amongst companies in the offshore oil and gas supply chain. The UKCS and the global oil sector is in a period of declining investment, re-assessment of projects and heightened concerns as to costs. However the recent announcement of tax changes may lead to both improved levels of business confidence and activity. The Aberdeen & Grampian Chamber of Commerce Oil & Gas Survey (published November 2009) noted that activity in the UKCS, at least the short term, has been reduced and business confidence remains frail, although the recent improvement in the oil price was welcomed. The proportion of contractors reporting working at or above optimum levels in the UKCS eased to the lowest levels recorded by the survey, although some improvement is anticipated for 2010.

Skill shortages, a feature of previous years have eased, although this may well be due to a combination of reduced demand and a number of industry wide initiatives. Nevertheless, skill shortages and recruitment difficulties were again reported, although not to the same extent as in previous years. Average pay increase in 2009 eased to the levels reported in 2004, and the percentage reporting increasing pay was lower than in previous years. There was evidence of pay freezes and rate reductions, the ending of bonus payments and some reductions in terms and conditions.

Production

The latest Lloyds TSB Scotland Business Monitor (data to end November 2009) noted a stronger improvement in the production sector in contrast to the service sector which experienced a slight worsening of conditions in the three months to November 2009, with the trends in turnover much better than in either the second or third quarters of 2009.

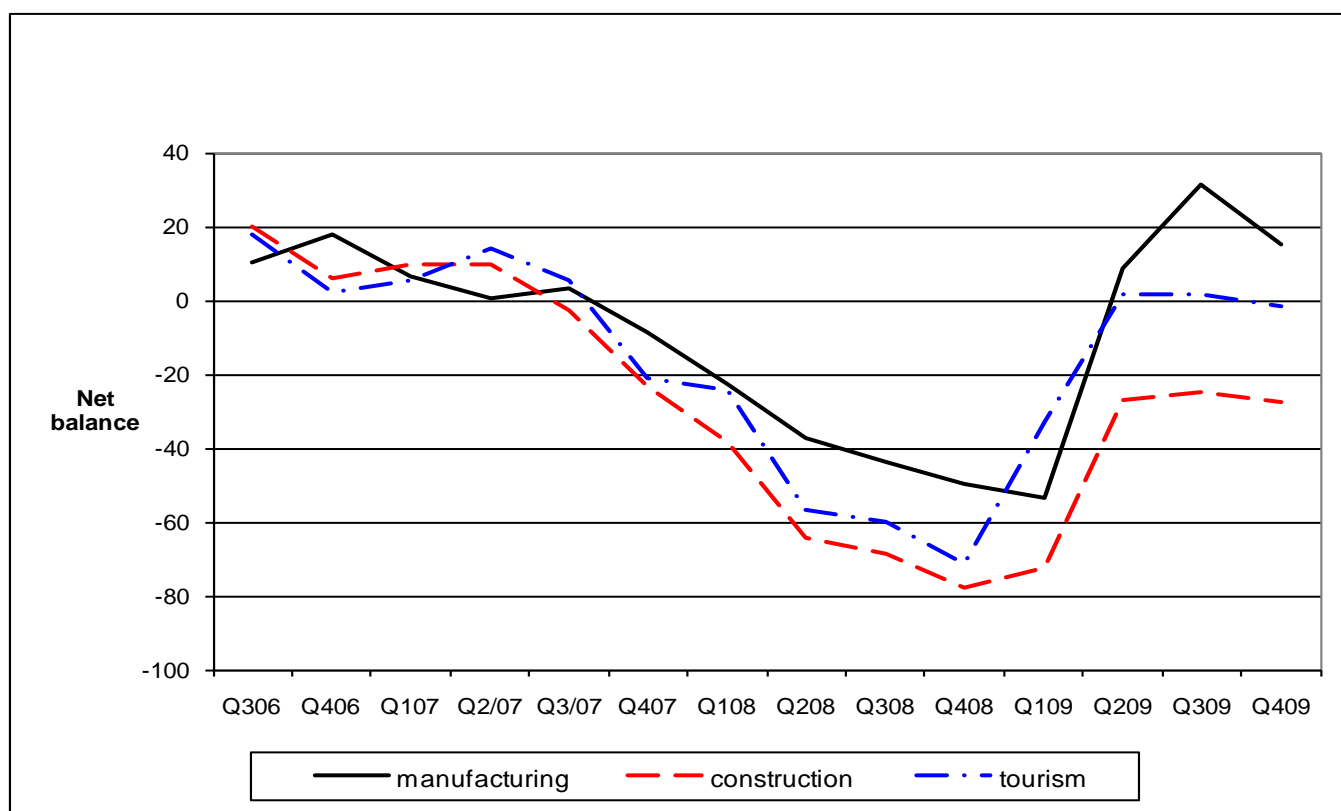
Manufacturing

The Scottish Chambers, CBI Industrial Trends and Scottish Engineering surveys for the fourth quarter reported net rising trends in business confidence. However, whilst the Scottish Chambers' Business Survey noted the rising trend in business confidence reported in the third quarter eased from a net balance of 32% in Q3 to 15% in Q4, Scottish Engineering and CBI Industrial Trends noted an improvement in business optimism between Q3 and Q4.

Orders and Sales

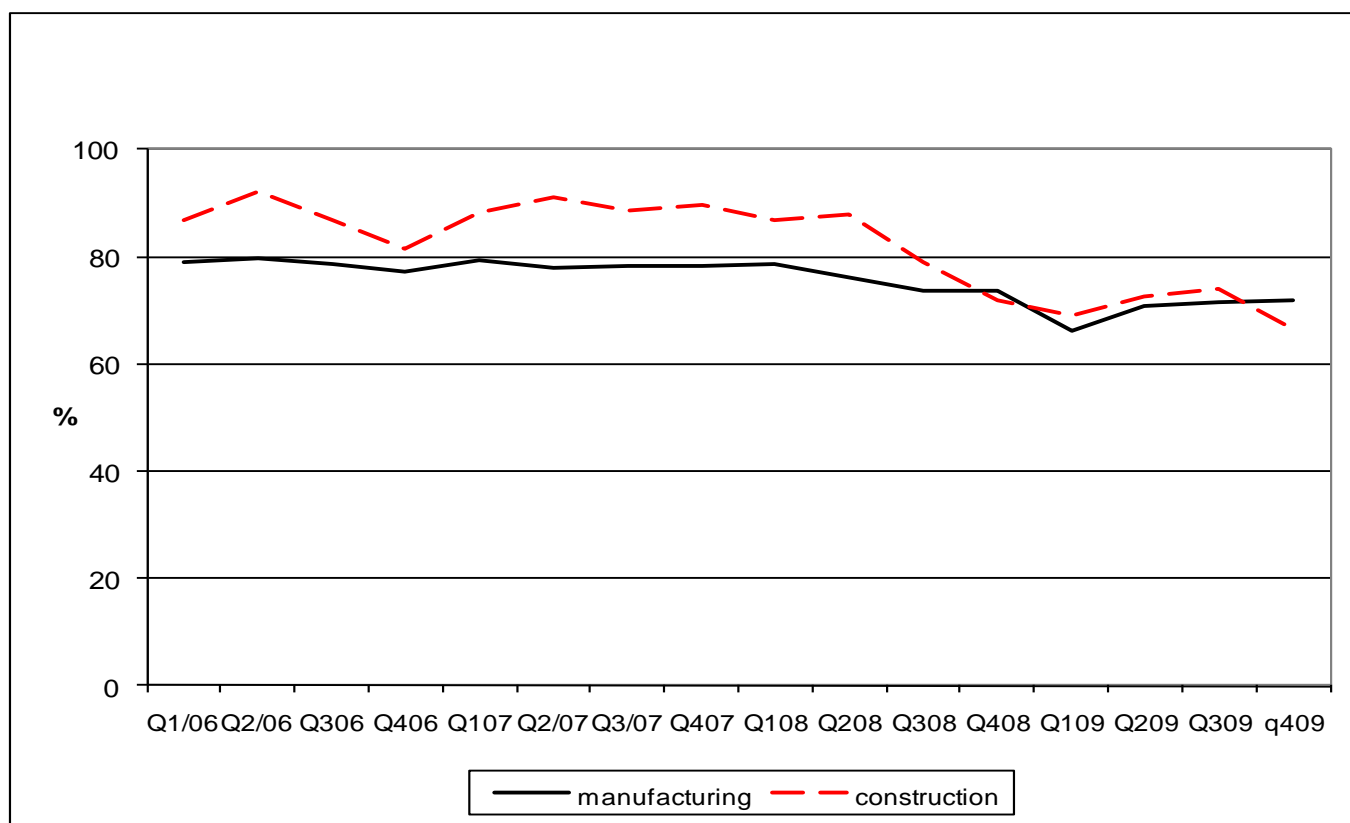
Scottish Chambers' and CBI Scotland respondents reported that the outturn in total new orders and export orders was weaker than expected in the fourth quarter, as the actual trends in total, Scottish and rest of UK orders remained weak and weaker than in the third quarter. In contrast, Scottish Engineering reported rising levels of orders and the 'overall level of orders is the best since 2008 with large and medium companies reporting rising trends'. Whilst overall rising trends are forecast for the first quarter of 2010 both

Table 1: Business confidence (net trends) manufacturing, construction and tourism – Scottish Chambers' Business Survey



Source: Scottish Chambers' Business Survey

Table 2: Average capacity used in manufacturing and construction



Source: Scottish Chambers' Business Survey

Scottish Engineering and Scottish Chambers' respondents are more cautious as to the level of improvement in orders.

Once again a declining trend in the level of work in progress was reported by Scottish Chambers' respondents, but the net decline is expected to end over the next twelve months, in contrast CBI Scotland respondents reported a slight improvement. Average capacity used by manufacturing respondents to the Scottish Chambers' Business Survey rose marginally by 0.3 percentage points to 71.9%, although 61% (57% in Q3 and 71% in Q2) reported capacity used was below preferred levels. Pressures to raise prices due to raw material costs and other overheads have been reduced by slowing costs inflation over the past year, but the effective devaluation of the pound has prompted concerns amongst both Scottish Chambers and CBI respondents of rising costs pressures and declining margins in 2010.

Investment

Scottish Chambers' respondents noted an improvement in investment trends as 29% expect to increase investment and 5% anticipate increasing their leasing of equipment over the coming year, this positive trend was not evident amongst CBI Scotland or Scottish Engineering respondents. Scottish Chambers' respondents noted cash flow trends improved compared to the past eight quarters. Respondents are more confident as to rising turnover during 2010, and the net trends are the most positive for eight quarters, in contrast expectations as to rising profitability eased.

Employment

Once again thirty-seven percent of Scottish Chambers' Business Survey manufacturing firms attempted to recruit and there was some evidence in both Scottish Chambers and CBI Industrial Trends surveys, but not in the Scottish Engineering survey, of a temporary rise in employment, although this is not expected to continue through the first quarter of 2010.

Construction

Optimism

Data from the latest Scottish Chambers' Business Survey (Q4 2009) noted business confidence remained weak with only 15% reporting being more confident compared to the previous quarter. The net balance of optimism at -28% was less depressed than a year ago Q4 2008 when a net of -78% was reported. Likewise the Scottish Construction Monitor (Q4 2009) described confidence as 'flatlining' and with many firms still 'fearful' about industry prospects in 2010, with 80% of respondents reporting being less confident or no more confident about the outlook for business in 2010. In sharp contrast recent figures from the annual survey conducted by the Construction Skills Network, forecast that Scottish construction would return to growth of 2.8% in 2010, unlike other parts of the UK, due

largely to the more important buoyant infrastructure sector in Scotland.

Contracts

Scottish Chambers' data suggested the rate of decline in the net trend in new contracts eased marginally from -40% in the third quarter to -38% at the end of 2009. The trends in orders from all sectors continued to decline although the rate of decline in domestic/house building orders eased.

Expectations as to turnover trends into 2010 remain depressed, and are forecast to deteriorate further during 2010. A net of -48% (-31%, -37%, -64%, and -65% in the previous four quarters) anticipate declining turnover trends. A net of -60% (-44%, -59% -78% and -78% in the previous four quarters) anticipate declining profitability over the next twelve months and a net of 72% of construction firms anticipate declining tender margins during the same period.

Average capacity declined by eight percentage points to 66%, although bad weather conditions may be a factor here, and almost 50% expect a declining trend in the level of work in progress.

Employment

More than half of firms reduced total employment levels with only 13% reporting an increase in employment and recruitment again remained at very low levels. Only 5% of respondents reported increasing pay in the fourth quarter by an average of 2%.

The service sector

The Lloyds TSB survey noted that service businesses experienced a slight deterioration of conditions during the three months to the end of November 2009, and given the importance of this sector 'may lead to Scottish recovery trailing that of the UK'.

Retail Distribution

Optimism

The Scottish Chambers' Business Survey noted weak trends in business confidence in 2009 Q4, as the trend in business confidence declined from -8% in Q3 to -35% in Q4, reflecting the pressures independent and smaller retailers from weak demand, internet sales and the policies of the major multiple retailers. Nevertheless, despite the decline the overall trend was less depressed than Q4 2008 (-91%) and Q4 2007 (-42%).

Sales

The Scottish Retail Sales Monitor reported solid December shop sales, with like-for-like sales 1.4% higher than in December 2008, total sales were reported as 4.3% up on a year ago. At least half of retailers reported and expect declining

sales in the fourth and first quarters. The rate of decline in actual and expected sales accelerated during quarter four although remained less depressed compared to Q4 2008.

Finance

Both turnover and profitability are expected to decline further for a net of retailers over 2010, although the rate of decline is less than that anticipated by firms during quarter three 2009. Two-thirds of retail respondents expect price increases during Q1 2010.

Employment

Most firms reported and expect no change to employment with fewer than 5% increasing or expecting to increase total employment levels. During the three months to the end of December the percentage of firms actively recruiting rose from 23% to 33%. Nine percent of firms increased wages by 2.43%.

Tourism

Optimism

According to the Scottish Chambers' Business Survey the overall level of business confidence became negative for a small net balance of responding firms although trends remained broadly unchanged from the previous quarter, and was significantly less depressed than in the same quarter of 2008.

Demand

The net trend in total demand remained positive in quarter four. The rate of increase slowed although the overall trend was better than anticipated. Domestic demand continued to exhibit stronger trends than demand from abroad and business demand. Average occupancy declined from 72% to 62% (higher than in Q4 2008, but marginally lower than in Q4 2007). The Scottish Occupancy study (data for November 2009) noted average room occupancy at 59%, the same as a year ago, and only one percentage point higher than the average reported for November 2005, 2006 and 2007. Occupancy figures were highest in Edinburgh & the Lothians and Glasgow & Clyde regions and lowest in the Highlands and Islands

Chamber of Commerce respondents report continuing to reduce room rates and the discounting of prices is more marked than during the same quarter a year ago and is set to continue in the first quarter.

Business constraints

An overall lack of demand remained the primary business constraint although hotels were also concerned with competition, exchange rates and poor transport infrastructure.

Employment

Changes in employment levels were reported by half of firms. Net declining trends in full time (-19%), part time (-17%), seasonal (-31%) and overtime working (-52%) were reported.

Outlook

The Scottish Chambers' Business Survey noted manufacturing trends continue to offer the clearest signs of an emerging, but weak and fragile recovery; tourism continues to report better trends than a year ago. The CBI Industrial Trends Survey reported 'In the industrial sector uncertainty about demand is still the factor most likely to limit capital spending.' The trends for 2010 remain uncertain; the fragile recovery will have to contend with a possible weakening in consumer spending, the costs of a harsh winter, the re-imposition of VAT, and pressures on Government expenditure, as the latest Lloyds TSB survey noted 'the recovery will be slow and tentative with many sectors delaying a recovery into growth until well into 2010'. Pressures on margins and likely pressures on raw material and other costs highlight the fragility of the recovery and both Scottish Chambers and Markit PMI Scotland highlighted rising input price inflation coupled with weak demand and the need to discount prices to sustain and improve order levels, although the CBI Industrial Trends survey was more optimistic. The labour market continues to remain weak with few signs of an improvement.

Cliff Lockyer /Eleanor Malloy
February 2010

Current trends in Scottish Business are regularly reported by a number of business surveys. This report draws on:

1. The Confederation of British Industries Scottish Industrial Trends Survey for the fourth quarter of 2009;
2. Lloyds TSB Business Monitor 48 for the quarters September – November 2009 and expectations to February 2010;
3. Scottish Engineering's Quarterly Reviews for the fourth quarter of 2009;
4. The Markit Economics Regional Monthly Purchasing Managers' Index for November and December 2009;
5. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor for November and December 2009;
6. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the fourth quarter of 2009;
7. Oil & Gas UK quarterly Index quarter 3 2009;
8. Visit Scotland Occupancy Survey November 2009;
9. The Scottish Construction Monitor quarter 4 2009;
10. The Construction Skills Network Annual Survey 2009.